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(R75-625)
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17 February, 1976

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Mr. Donald Vance
Executive Secretary
ARIZONA CORPORATION COMMISSION
2222 West Encanto Boulevard
Phoenix, Arizona 85018

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Dear Mr. Vance:

In a request from your Division, the following question was asked:

Does the Commodity Futures Trading Commission Act of 1974, which became effective as of April 21, 1975, preempt the provisions of the Arizona Securities Act and the Rules and Regulations adopted pursuant thereto authorizing the State of Arizona to regulate the issuance of "commodity investment contracts" on those commodities as defined by the Act under Section 44-1801 of the Arizona Revised Statutes?

In May, 1974, the Arizona Legislature amended the Arizona Securities Act (A.R.S. Section 44-1801, et seq.) to include certain commodity investment contracts and commodity options. Laws 1974, Chapter 126. While the Securities Act previously covered "investment contracts", which could involve any subject matter, including commodities, the Legislature decided, due to certain abuses in the commodities futures area (particularly abuses in precious metal investment transactions), to enact legislation subjecting certain commodity contracts and practices to the regulation of the Securities Division, Arizona Corporation Commission. The amendments generally consisted of the following:

1. Contracts whereby a purchaser made any payment for certain commodities



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(e.g., cocoa, coffee, copper, gold, platinum, silver and precious coins), but was not entitled to receive the commodities within 28 days of that payment, were declared "commodity investment contracts", and were made subject to registration with, and regulation by the Securities Division. A.R.S. §44-1801.2-.3. An exemption eliminated dealer and securities registration requirements if the commodity contracts being sold were traded on a commodities exchange recognized by the Commission. To date the Commission recognizes several major exchanges. A.R.S. §44-1844.13; R14-4-125, A.C.R.R.

2. Contracts whereby a purchaser pays a premium or fee for the privilege of purchasing or selling a commodity investment contract (involving the commodities specified in the Securities Act) within a future specified period at a specified price, were declared "commodity options" and also were made subject to registration and regulation by the Securities Division. No exemption for certain classes of options was provided. A.R.S. §44-1801.4,

3. The Securities fraud statute was extended by definition changes, to cover fraudulent transactions involving commodity investment contracts and options. A.R.S. §§44-1801.16 and 44-1991.

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Subsequent to the enactment of those amendments, the Securities Division promulgated two regulations concerning this subject matter, A.C.R.R., R14-4-124 (S-24) and R14-4-125 (S-25). The first rule established financial requirements for persons applying to transact business in commodity investment contracts or options, and the second listed the commodities exchanges recognized by the Securities Division for purposes of exempting certain commodity investment contracts from registration.

It had been the informal interpretation of the Attorney General and of the Securities Division that at least the following specific varieties of commodity contracts were covered by the amendments:

1. Commodity margin or leverage contracts involving gold, silver or the other listed commodities.
2. Commodity sales contracts (involving listed commodities) not requiring delivery within 28 days of payment.
3. Certain other commodity futures contracts not traded on a recognized exchange and requiring at least partial payment "up front" more than 28 days before delivery of the commodity.
4. Commodity options involving listed commodities.

Less than six months after the effective date of the Arizona law regulating commodity investment contracts and options, the United States Congress enacted the Commodity Futures Trading Commission Act of 1974, Public Law 93-463 (CFTCA). This Act substantially amended the Commodity Exchange Act of 1936 (7 U.S.C. §§1-17(b)) to strengthen the regulation of futures trading and to include substantially all commodities traded on exchanges within that regulation. Key provisions of the CFTCA provide:

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1. A new independent regulatory body, the Commodity Futures Trading Commission ("Commission") (§101),
2. Expansion of the "commodities" definition to include practically all commodities, goods, articles, rights, services and interests which involve future contracts (§201),
3. A grant of exclusive jurisdiction to the Commission concerning commodity options, privileges, bids, offers, guaranties, puts and calls, and transactions involving contracts of sale of a commodity for future delivery traded as designated commodity exchanges or "contract markets" (§201),
4. Persons dealing in, soliciting sales or purchases, accepting orders, pooling assets of others for purpose of commodity trading, and advising others regarding commodity futures trading are required to register with the Commission (§§202-206),
5. Detailed regulatory powers concerning commodity futures, options, etc., and persons transacting business involving such contracts (§§201-217),
6. Specific exclusive authority to regulate gold, silver, and coin margin or leverage account contracts (§217),
7. Regulation of exchanges or "contract markets". Trading of commodity futures are permitted only through members of such exchanges (§§210-213),

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8. Civil and criminal penalties for fraud and other violations and injunction powers (§§211 & 212).

As the above provisions indicate, Congress provided the Commission with comprehensive regulatory powers over commodity contracts, commodity exchanges, persons involved in commodity transactions, and particularly gold and silver margin contracts. More significant, Congress explicitly granted exclusive jurisdiction to the Commission with regard to all types of commodity options and commodity investment contracts traded on designated exchanges, and gold and silver margin contracts. In addition, Congress repealed the last sentence of 7 U.S.C. 6 c., which had provided:

Nothing in this section or section 6 b of this title shall be construed to impair any State law applicable to any transaction enumerated or described in such sections.
(Emphasis added)

The U. S. Supreme Court, in Rice v. Board of Trade, 331 U.S. 247 (1947), had held the Commodity Exchange Act then in effect did not preempt state regulation, citing four reasons:

1. Congress had not indicated that federal commodities regulation was exclusive.
2. Certain areas were not regulated by the federal scheme.
3. 7 U.S.C. 6 c expressly or implicitly preserved state regulation.
4. Cooperation with state agencies was authorized.

It appears Congress has nullified the effect of the Rice case in that three of the four reasons for that holding now have been eliminated by Congress. First, as mentioned,

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Congress now has indicated that the Commission's jurisdiction generally is exclusive. Second, the present federal regulatory scheme concerning commodity contracts is substantially broader and more definitive than the Commodity Exchange Act, clearly substantially occupying the commodities regulation field. Third, and most important, Congress repealed Section 6 c permitting state regulation.

The House Conference Report (No. 93-1383, September 27, 1974) which described the CFTCA is very instructive:

Under the exclusive grant of jurisdiction to the Commission, the authority in the Commodity Exchange Act (and the regulations issued by the Commission) would preempt the field insofar as futures regulation is concerned. Therefore, if any substantive State law regulating futures trading was contrary to or inconsistent with Federal law, the Federal law would govern. In view of the broad grant of authority to the Commission to regulate the futures trading industry, the Conferees do not contemplate that there will be a need for any supplementary regulation by the States. (Emphasis added).

The Commission has made its views on this matter clear:

Nevertheless, I feel obligated to emphasize our view that the plain language of the Commodity Futures Trading Act of 1974, and its legislative history . . . especially when read in light of the Federal case law concerning preemption over the past three decades . . . shows conclusively that Congress intended to preempt and has preempted the states concerning three types of transactions: those involving

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commodity futures contracts; those involving gold and silver coins or bullion sold on margin accounts; and those involving options with respect to commodities.

Speech of John V. Rainbolt
II, Vice Chairman
Commodities Futures Trading
Commission
North American Securities
Administrative Conference -
September 9, 1975

There is little doubt, in view of legislative history that Congress has manifested its intent to occupy this field, and that the CFTCA preempts substantially all the state regulatory functions with regard to commodity futures contracts, gold and silver margin contracts and commodity options.

Therefore, it is our opinion the following portions of the 1974 commodities regulation amendments of the Securities Act and Regulations promulgated thereunder are preempted by the CFTCA:

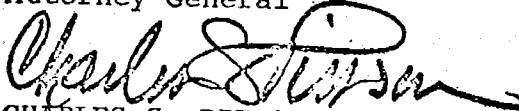
1. Those provisions providing for registration and regulation of commodity options, and dealers thereof.
2. Those provisions providing for registration and regulation of commodity investment contracts, including gold and silver margin contracts, and dealers thereof.
3. Those provisions providing for general regulation or administrative action by the Securities Division with regard to commodity investment contracts and commodity options.

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This Opinion in no way limits the availability of the "investment contract" theory or other theories used in Securities Law when applicable to commodity transactions. We express no opinion at this time regarding the general use of A.R.S. §44-1991 by law enforcement agencies in commodities fraud actions or prosecutions.

Sincerely,

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